SUPREME COURT OF THE UNITED

OCTOBER TERM, 1948

No. 601

IN THE MATTER OF
THE PEORIA AND EASTERN RAILWAY COMPANY

EPPLER & COMPANY,
Petitioner,
v.
THE NEW YORK CENTRAL RAILROAD COMPANY, THE CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS RAILWAY COMPANY AND THE PEORIA AND EASTERN RAILWAY COMPANY,

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

GEORGE W. JAQUES,
Counsel for Petitioner.

MILBANK, TWEED, HOPE & HADLEY,
and GEORGE W. JAQUES,
Attorneys for Petitioner.
EUGENE H. NICKERSON,
Of Counsel.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

Eppler & Company, petitioner, respectfully prays that a writ of certiorari issue to the United States District Court for the Southern District of New York, to review the order of that Court, sitting as a three-judge Special Court, which order was entered on December 28, 1948 (R. 73-75) in the

Railroad Adjustment Proceeding, entitled *In the Matter of Peoria and Eastern Railway Company*, denying the petition of Eppler & Company (herein called "Eppler") for an allowance for certain services and disbursements rendered in the proceeding. Section 745 of the Bankruptcy Act provides for such direct review in this Court. See p. 7, *infra*.

Opinion Below

The opinion of the District Court appears at R. 69-73 and is not yet reported.

Statement of Matter Involved

This case arises in the Railroad Adjustment Proceeding of The Peoria and Eastern Railway Company (herein called "The Peoria") under Chapter XV of the Bankruptcy Act. 53 Stat. 1134 (1939).[1] The District Court disapproved that part of the petition on behalf of Eppler, a firm of accountants, which sought $47,005.16 for testifying and preparation of factual data and exhibits in the proceeding. The Court held that although the sum was "reasonable in amount both as to the services rendered and the expenses incurred," the Court could not charge the amount against The Peoria.

Nature and Summary of the Issues

This petition concerns a further phase of *Income Bondholders of The Peoria and Eastern Railway Company* v. *The New York Central Railroad Company, et al.*, now pending on petition for certiorari to this Court, No. 511, October Term, 1948.

The petition already before the Court is concerned with Adjustment Proceeding of The Peoria, and more specifically relates to the accounts between The New York Central Rail-

[1] This Chapter XV expired on July 31, 1940, Bankruptcy Act, § 755, but jurisdiction of the cases pending on that date (including this case) was reserved by §§ 746 and 755.

road Company and The Cleveland, Cincinnati, Chicago & St. Louis Railway Company (herein called the "Operating Companies") and The Peoria. The accountants' services and disbursements for which compensation was sought by Eppler in the present case were rendered in the Adjustment Proceeding.

In order to understand the background of this petition, it is necessary to recall the outlines of the proceeding already before the Court. The Operating Companies are fiduciaries of The Peoria, its majority stockholder, and dominate and control it. They apportion the joint revenues and expenses and determine the intercompany financial accounts. The basic issues before the Court in the Adjustment Proceeding are whether those fiduciaries must, in accordance with the usual standard, be fair to The Peoria and whether they bear the burden of establishing such fairness in their self-dealing transactions.

Those issues arose in the following context. In 1940 the First Mortgage Bonds of The Peoria were about to fall due, and an Operating Agreement of 1890, under which the Operating Companies operated The Peoria, was about to expire. Pursuant to Chapter XV of the Bankruptcy Act, § 710(2), The Peoria filed with the Interstate Commerce Commission an application for authority to modify its securities in accordance with a Plan of Adjustment, including an extension of the maturity date of the First Mortgage Bonds, and to renew the Operating Agreement of 1890 until 1960 (239 I. C. C. 303). The Interstate Commerce Commission approved the Plan of Adjustment and the extension of the Operating Agreement (239 I. C. C. 303, 320). The Peoria then instituted proceedings in the District Court pursuant to Chapter XV of the Bankruptcy Act.

A committee of Income Bondholders having been permitted to intervene, opposed the Plan of Adjustment, and

argued, in part, that the claim of the Operating Companies for an alleged debt of $2,500,000 should not be allowed. The District Court approved the Plan of Adjustment. *Ewen* v. *Peoria & E. Ry. Co.*, 34 F. Supp. 332 (1940). But the Court left open the question of whether the claim of the Operating Companies was valid, and provided in § 24 of its decree that should the Operating Companies seek to withdraw any part of the earnings of The Peoria to repay the alleged intercompany accounts, then, upon objection by a representative of the Income Bondholders elected to the board of directors as provided by the Court's order, the Operating Companies "must prove and establish their right to do so." *In re Peoria & Eastern Ry. Co.*, 37 F. Supp. 917 (1941).

In 1943 the director of The Peoria who represented the Income Bondholders objected in accordance with the Court's decree to a proposed withdrawal by the Operating Companies of earnings of The Peoria (R. 19). The Operating Companies, thereupon, petitioned for the appointment of a Master to hear and report on the validity of the claim of the Operating Companies, and prayed that the order approving the Plan be modified as might be just and proper (R. 2-11).

By order of May 21, 1943 the District Court appointed a Special Master and also appointed Charles S. Aronstam, Esq. as counsel to represent the Income Bondholders, and provided that the latter "with the approval of the Special Master may employ accountants and traffic experts to assist him in connection therewith" (R. 13-14, 24).

Eppler was then approached in June, 1943 to make a study of the intercompany accounts between The Peoria and the Operating Companies (R. 26). After making a preliminary examination of the issues, Eppler advised counsel for the Income Bondholders that it would be willing to accept employment if the Operating Companies were

agreeable and provided that Eppler would be free to discuss with the Operating Companies all questions affecting the intercompany accounts (R. 26). On June 21, 1943 the representatives of the majority stock interest in The Peoria, namely, the Operating Companies, and the representatives of the interests of the Income Bondholders approved the appointment of Eppler (R. 26-27). Thereafter a formal application to the Master, the representative of a third body having an interest in The Peoria, namely, the Court, was made for approval of the employment (R. 27). The Master approved the employment of Eppler and read into the record its schedule of rates (R. 27-29). After Eppler had been employed and had commenced its examination of intercompany accounts, the District Court, by order dated July 2, 1943, approved the appointment of one Adams as attorney to represent The Peoria (R. 22). Without any consultation with the director of The Peoria representing the Income Bondholders (R. 55), the Operating Companies selected and nominated Adams to represent their adversary, The Peoria (R. 36, *cf.* 11 with 17).

The results of Eppler's examination of the intercompany accounts, which consumed many months, were embodied in the so-called "Eppler Report." The report found that the transactions reflected in the intercompany accounts from 1920 through 1942 deviated from fair and standard railroad practices (R. 37). The report concluded that had fair railroad practices been used by the Operating Companies the alleged debt to them did not exist, and that instead they owed The Peoria some $12,000,000 in principal amount (R. 37).

The Eppler Report was delivered to the Operating Companies on July 5, 1944, to the end that the parties might meet for the purpose of narrowing the issues before the Master (R. 29-30). Although the Operating Companies took over six months to examine the Eppler Report and

supporting data, they refused to discuss the items contained therein but instead stated that they were ready to proceed with the hearings (R. 29-30). It thus became necessary to present in Court the entire case on behalf of The Peoria on the issues as contained in the Eppler Report. Eppler was therefore required to render services in the proceedings, testifying before the Special Master, and preparing exhibits and other data.

The District Court approved payment of the bill of Eppler for services and disbursements in connection with the preparation of the Eppler Report (R. 70-73). The Court said: "the work of these experts was not duplicative of that of other employees retained by the petitioning debtor and the basic data assembled was available to the debtor and to others," that although the conclusions in the Report were not accepted by counsel for The Peoria, "the study threw a flood of light upon the field of controversy, and, on all the facts viewed against the situation then existing, we are satisfied that it constituted a service to the debtor and should be treated as an item of expense to the debtor." (R. 72). The Court approved payment of the bill for rendering the Eppler Report as being "at a rate which seems to us reasonable," namely, $72,073.44 (R. 72).

The Court, however, denied compensation to Eppler for testifying before the Special Master and for preparing exhibits and other data, although it concluded that the bill for such services, namely, $47,005.16 was "reasonable." The Court said it could not classify as expenses of the debtor's estate such services since they had been rendered at the "call" of counsel for the Income Bondholders (R. 72-73).

Jurisdiction

The order of the Special District Court was entered on December 28, 1938 (R. 73-75). Jurisdiction of this Court

is invoked under §745 of the Bankruptcy Act, which provides that "Any final order or decree of the special court may be reviewed by the Supreme Court of the United States upon application for certiorari made by any person affected by the plan who deems himself aggrieved within sixty days after the entry of such order or decree, pursuant to the provisions of the Federal Judicial Code."

The controversy with respect to the validity of the intercompany accounts, although postponed to the final stages of the Adjustment Proceeding, was, of course, an integral part of it. The Plan of Adjustment of The Peoria proposed to leave unchanged the status of the claim of the Operating Companies against it, but the District Court in its decree modifying the Plan left this portion open and reserved it for future determination. The final decree of the District Court settling the intercompany debt was by its own terms an amendment to the decree approving the Plan.

By the same token the payments to Eppler were a necessary part of any plan approved by the District Court. Section 725 of the Act provides that the Court shall enter a decree approving or modifying the Plan only if it finds, among other things:

> "(6) That, after hearings for the purpose, all amounts or considerations, directly or indirectly paid or to be paid by or for the petitioner for expenses, fees, reimbursement or compensation of any character whatsoever incurred in connection with the proceeding and plan, or preliminary thereto or in aid thereof, together with all the facts and circumstances relating to the incurring thereof, have been fully disclosed to the Court so far as such amounts or considerations can be ascertained at the time of such hearings, that all such amounts or consideration are fair and reasonable, and to the extent that any such amounts or considerations are not then ascertainable, the same are to be so disclosed to the Court when ascertained, and are to be sub-

> ject to approval by the special court as fair and reasonable, and except with such approval no amounts or considerations covered by this clause (6) shall be paid."

Thus any plan to be approved by the Court must contain appropriate provision for the payment by the petitioner of "expenses, fees, reimbursement or compensation of any character whatsoever incurred in connection with the proceeding and plan." As the Court said, with respect to fees in reorganization proceedings, in *Leiman* v. *Guttman*, No. 88, this Term, decided January 17, 1949, "The incidence of fees on reorganization plans is so great that control over them is deemed indispensable to the court's determination whether the plan should be confirmed." The same thing is true with respect to the payment of fees in a Railroad Adjustment proceeding. The payment of appropriate fees is an essential part of the plan.

There can also be no doubt that Eppler is "affected by the plan." It is significant that although by § 706 of the Act a "creditor" is not deemed to be "affected" by the plan unless it proposes a "modification" of the instrument defining the creditor's rights or of the security for the creditor's claim, review is authorized by § 745 on petition not merely of any "creditor" but of "any person" affected.

Eppler "deems" itself clearly "aggrieved" within the terms of § 745, having been denied more than one-third of its compensation for services and disbursements rendered.

Questions Presented

1. Whether petitioner, appointed with the approval of the Special Master, whose *per diem* rates for time spent attending in Court as witnesses and in preparation of the case were actually read into the record by the Master, should be deprived of an allowance for such services and disbursements.

2. Whether the services rendered by petitioner in testifying and preparation of exhibits and data were "duplicative" of the work of others, although no such work was performed by others on behalf of The Peoria.

3. Whether the District Court properly denied an allowance for services and disbursements.

Reasons Relied On for Allowance of Writ

Section 725(6), *supra*, pp. 7-8, of the Railway Adjustment Act provides, in pertinent part, that all amounts "directly or indirectly paid or to be paid by or for the petitioner for expenses, fees, reimbursement or compensation of any character whatsoever incurred" in connection with the proceeding are "subject to approval by the special court as fair and reasonable." The Court below allowed Eppler no compensation at all for testifying and preparing exhibits and data in connection with the case, because it did not consider that such work was "for" The Peoria, within the terms of the statute, apparently on the ground that the work was performed at the "call" of Mr. Aronstam, who had been appointed as counsel for the Income Bondholders, whereas the estate of the debtor was "adequately represented" by other counsel.

The error in this ruling is plain from the circumstances under which Eppler was employed. Eppler was not employed to assist one group of security holders in The Peoria against another. All the work of Eppler was performed solely on behalf of The Peoria, as an entity, against the Operating Companies, which Eppler found had been unfaithful to their trust in apportioning joint revenues and expenses and in determining the intercompany financial accounts and had misstated the accounts to the extent of more than $12,000,000.

It is true that issues had been raised in the Adjustment Proceeding with respect to the relative claims of the various

classes of security holders in The Peoria as against each other. Those issues were determined in prior proceedings before the District Court. *Ewen* v. *Peoria & E. Ry. Co.*, 34 F. Supp. 332 (1940); *In re Peoria & Eastern Ry. Co.*, 37 F. Supp. 917 (1941). But the Court specifically left open the claim of The Peoria, on the one hand, against the Operating Companies, on the other. The proceeding involving the contest on that claim, and which did not concern the relative claims of the classes of security holders in The Peoria, was the proceeding in which Eppler rendered services.

At the inception of the contest between The Peoria and the Operating Companies, the order dated May 21, 1943 was entered providing (a) for the appointment of counsel of the Income Bondholders, the only group in the proceeding asserting the interest of The Peoria against the Operating Companies, and (b) for the employment, with the approval of the Master, of accountants and traffic experts in connection with the proceeding.

By reason of the fact that the Railroad Adjustment Act makes no provision for the appointment of a trustee or receiver of the debtor's estate, no such official was available to prosecute the action for The Peoria against the Operating Companies. The representative of the Income Bondholders was therefore appointed by the Court to perform the task which in an ordinary proceeding it would have been the duty of a trustee or receiver to perform. The Court plainly had power to make that appointment, since § 713 of the Act provides that the Court "shall be vested with and shall exercise all the powers of a district court sitting in equity and all the powers as a court of bankruptcy necessary to carry out the intent and provisions" of the Act.

Any appointment of counsel who might have been suggested by the corporate directors in control of The Peoria,

all but one of whom were officers or directors of the Operating Companies, might not have assured undivided loyalty to The Peoria to the entity in which all security holders had a stake. Although after Eppler's employment a Vice President of the Operating Companies, also a Vice President of The Peoria, applied for the appointment of additional counsel to represent The Peoria, the order appointing such counsel made no provision for the employment of accountants. The necessary work by accountants had already been provided for in the order of May 21, 1943.

It is hornbook law that services, including accountant's services, performed for one bearing an official status, such as a receiver or trustee who brings or defends an action against an outside party on behalf of the estate are compensable out of the estate, regardless of the outcome of the action. 1 Clark, Receivers (2d ed.), § 642, and cases cited; High, Receivers, § 811; 3 Collier, Bankruptcy, 14th ed., §§ 62.09-62.12, and cases cited.

Thus a receiver or trustee has been held entitled to reimbursement for such expenses incurred in such an action in which he had been defeated, whether brought against him by another, *Missouri & K. I. Ry. Co.* v. *Edson*, 224 Fed. 79, 82-83 (C. C. A. 8th 1915), or by him against another. *In re Flaherty*, 295 Fed. 699, 701 (D. Mont. 1924); *In re Hoffman*, 173 Fed. 234 (E. D. Wisc. 1909); *cf. In re Owl Drug Co.*, 16 F. Supp. 139, 142-143 (D. Nev. 1936, *aff'd, sub nom, Cohn* v. *Elder*, 90 F. 2d 823 (C. C. A. 9th 1937).

Had a receiver or trustee been available to assert the interest of The Peoria against the Operating Companies, there can be no doubt that the expenses incurred for the fees of accountants, appointed pursuant to Court order, would be paid from the assets of the debtor.

Upon his appointment by the Court to perform the duty ordinarily incumbent on a receiver or trustee, the counsel for the Income Bondholders stood, from the viewpoint of payment of the accountants' fees, in an official position analogous to that of a receiver or a trustee bringing and defending an action against an outside party. Services rendered by accountants employed by him are therefore compensable in the same manner as if they had been rendered to a receiver or a trustee. The fact that the appointment of a receiver or trustee of The Peoria was not provided for in the Railroad Adjustment Act did not leave The Peoria at the mercy of the Operating Companies and did not make the services of accountants any less vital to the prosecution, approved by the Court, of the claim of The Peoria against the Operating Companies.

It was urged below that the District Court's prior decision, *In re Peoria & Eastern Railway Company,* 37 F. Supp. 917 (1941), *cert. denied,* 314 U. S. 635 (1941), is authority for the proposition that the Court has no power to permit payment of the Eppler bill. The Court below rejected that contention. The prior decision is plainly inapposite. The entire proceeding which culminated in that opinion concerned issues between the various classes of security holders as against each other, with respect to their relative claims in the assets of petitioner. Since the statute required that compensable expenses be those "directly or indirectly paid or to be paid by or for the petitioner", the Court held that fees could not be allowed to attorneys who acted not derivatively on behalf of The Peoria as a whole, but rather on behalf of a rival claimant to The Peoria's assets.

In this proceeding, on the other hand, the entire contest was not between rival claimants to The Peoria's assets but

between The Peoria itself and outside entities asserting a contrary interest.

It was plainly erroneous of the Court below to hold that Eppler should not be paid for testifying and preparing exhibits and data on the ground that the debtor was "adequately represented" by others. The work of Eppler was not in any sense duplicative of the work of others. The Eppler Report was the basis for the claim of The Peoria for $12,000,000 against the Operating Companies. The testimony of Eppler and the data which it prepared constituted the core of The Peoria's case. Indeed counsel selected by the Operating Companies to represent its adversary The Peoria opposed the bulk of the conclusions reached by the Eppler Report, and the Eppler testimony and data were thus not in any sense repetitive of any material introduced by him, but were, in the main, likewise opposed by him.

The employment of Eppler was approved by the Master in accordance with the order of the District Court designating counsel and permitting him "with the approval of the special master" to "employ accountants and traffic experts to assist" in connection with the proceeding. Moreover, all groups which asserted an interest in The Peoria approved the employment: the Operating Companies, having a majority stock interest, the Income Bondholders, and the officer of the Court (R. 26-27). It was never suggested that Eppler should, contrary to the consistent practice of accountants, take employment on a contingent basis. Furthermore, Eppler's *per diem* rates were read into the record by the Master, including the following statement as to court attendance: "The charges for time spent in attendance at court as witnesses, or waiting to be called as witness, and time spent in conference with counsel and

working with counsel in preparation of case, shall be based upon the foregoing rates, except that any part of a day less than seven hours so spent shall constitute a day." (R. 29).

The charges for time spent by Eppler in Court or in preparation of the case were as much agreed upon by the parties as were the charges for preparation of the Eppler Report. The services rendered in Court were as essential to The Peoria as those involved in preparation of the report. Since the Court below held that the report was rendered on behalf of The Peoria and that the expenses of its preparation were properly charged to The Peoria, the work and time necessary to sustain the conclusions of the report must also properly be chargeable to The Peoria.

The Court will appreciate that the issues involved in the proceeding pending before it in No. 511, this Term are of vast importance. In that case it is claimed that the Operating Companies were unfaithful to their duty as fiduciaries and owe The Peoria $12,000,000 principal amount. The testimony of Eppler and the data prepared by Eppler constitute the factual basis for this claim. Having rendered services in reliance upon the order of the Court and the approval of the Master, Eppler is entitled to the compensation which it had reason to expect.

Conclusion

Eppler has been deprived of more than one-third of the compensation for services which it rendered in reliance on the order of the District Court and the approval of the Master. The services of Eppler constitute the main basis for the claim of The Peoria that the Operating Companies misstated their accounts in the principal amount of $12,000,000. Having faithfully discharged its employment pur-

suant to Court order, Eppler should not be unjustly deprived of compensation for its services.

Wherefore, it is respectfully submitted that this petition for certiorari to review the order of the Special District Court for the Southern District of New York should be granted.

GEORGE W. JAQUES,
Counsel for Petitioner.

MILBANK, TWEED, HOPE & HADLEY,
AND GEORGE W. JAQUES,
Attorneys for Petitioner.
EUGENE H. NICKERSON,
Of Counsel.

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